

Honorable Thomas S. Zilly

UNITED STATES DISTRICT COURT FOR THE  
WESTERN DISTRICT OF WASHINGTON  
AT SEATTLE

ST. PAUL FIRE AND MARINE  
INSURANCE COMPANY, a Minnesota  
corporation and ST. PAUL GUARDIAN  
INSURANCE COMPANY, a Minnesota  
corporation,

Plaintiffs,

v.

HEBERT CONSTRUCTION, INC., et al.,

Defendants.

v.

ADMIRAL INSURANCE COMPANY, a  
Delaware corporation,

Third Party Plaintiff,

v.

AMERICAN ECONOMY INSURANCE  
COMPANY, an Indiana corporation, et al.,

Third Party Defendants.

) No. C05-0388TSZ

)  
) PLAINTIFFS ST. PAUL FIRE AND  
) MARINE INSURANCE COMPANY AND  
) ST. PAUL GUARDIAN INSURANCE  
) COMPANY'S MOTION FOR PARTIAL  
) SUMMARY JUDGMENT

) **Clerk's Action Required**

) **Note on Motion Calendar:**

) **July 21, 2006**

) **Oral Argument Requested**

## I. MOTION

Plaintiffs St. Paul Fire and Marine Insurance Company (“St. Paul Fire”) and St. Paul Guardian Insurance Company (“St. Paul Guardian”) (collectively “St. Paul”) move for partial summary judgment dismissing the defendants’ claims for (1) breach of contract against St. Paul Fire; (2) bad faith and Consumer Protection Act against St. Paul Fire and St. Paul Guardian and (3) underlying attorney’s fees as “costs taxed” against St. Paul Fire and St. Paul Guardian.<sup>1</sup>

## II. SUPPORTING MEMORANDUM

### A. Facts

#### 1. The Meadow Valley condominium

On March 10, 1998, defendant Meadow Valley, LLC (“MVLLC”) incorporated itself as a limited liability company in order to develop the Meadow Valley condominiums in Auburn, Washington.<sup>2</sup> Construction began in 1999 and was completed in 2000.<sup>3</sup> MVLLC was both the developer of the project and the declarant within the meaning of the Washington Condominium Act.<sup>4</sup> Defendant Hebert Construction, Inc. was the general contractor for the project.<sup>5</sup> The Meadow Valley Owners Association (“Association”) filed its articles of incorporation on February 24, 1999.<sup>6</sup> After the project was completed, the members of MVLLC controlled the Association until control passed to the unit owners in 2001.<sup>7</sup>

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<sup>1</sup> Defendants are MVLLC, Hebert Construction, Roger and Shelly Hebert, Henry and Karen Hebert, James and Anne Kossert and Andrzej and Roma Lawski (“Meadow Valley defendants”).

<sup>2</sup> Declaration of Stephanie Andersen in Support of Plaintiffs St. Paul Fire and Marine Insurance Company and St. Paul Guardian Insurance Company’s Motion for Partial Summary Judgment (“Andersen Decl.”), Exhibit 1.

<sup>3</sup> Andersen Decl. Exh. 2.

<sup>4</sup> Andersen Decl. Exh. 3.

<sup>5</sup> Andersen Decl. Exh. 4.

<sup>6</sup> Andersen Decl. Exh. 5.

<sup>7</sup> Andersen Decl. Exh. 6.

## 2. Hebert Construction and MVLLC's construction liability insurance

Roger Hebert and his older brother Henry formed Hebert Construction in 1979 and are its principals.<sup>8</sup> They are also two of the four members of MVLLC. Roger is MVLLC's managing member.<sup>9</sup> Edith Jacks of Marsh McLennan was the long-time insurance broker for all the Hebert brothers' legal entities, including Hebert Construction and MVLLC.<sup>10</sup>

Fidelity & Guaranty Insurance Company, a predecessor company to St. Paul Fire and St. Paul Guardian, issued a construction liability policy to Hebert Construction effective January 4, 1998 to January 4, 1999. MVLLC was not an insured under this policy.<sup>11</sup> When this policy expired St. Paul Guardian issued construction liability policy no. KK08400026, effective January 4, 1999 to January 4, 2000, to Hebert Construction and MVLLC. St. Paul Guardian charged \$12,934 in liability premiums for this policy.<sup>12</sup> The policy's liability form, form no. 47175, begins: "This insuring agreement provides general liability protection for your business."<sup>13</sup> The St. Paul Guardian policy did not insure either condominium associations or unit owners.<sup>14</sup>

In November 1999, three-quarters of the way into the policy period, St. Paul notified Ms. Jacks it would not be renewing the St. Paul Guardian policy "due to the significant construction defect loss potential":

As we discussed last week, we will not be in a position to renew Hebert Construction, Inc. The premium size is smaller that we currently would like, but more importantly one of the entities is involved with the construction of

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<sup>8</sup> May 25, 2006 Deposition Transcript of Roger Hebert ("Hebert Dep."), p. 7, 11. 20-25, p. 8, ll. 1-8; Andersen Decl. Exh. 7.

<sup>9</sup> *Id.* at p. 25, 11. 9-18, p. 48, ll.18-25, p. 49, l. 1; Andersen Decl. Exh. 7.

<sup>10</sup> Declaration of Edith Jacks ("Jacks Decl."), ¶ 3.

<sup>11</sup> Andersen Decl. Exh. 8.

<sup>12</sup> Andersen Decl. Exh. 9 at SPT00837.

<sup>13</sup> *Id.* at SPT00927.

<sup>14</sup> *Id.*

1           habitational buildings. *We are not a market for this kind of contractor due to the*  
 2           *significant construction defect loss potential.*<sup>15</sup>

3           Ms. Jacks' colleague, Cheryl Smith, requested more time to find replacement coverage for her  
 4           clients. As Ms. Smith's telephone note shows, the St. Paul underwriter with whom she was  
 5           negotiating was reluctant to oblige, telling her she would get fired if she allowed St. Paul to  
 6           remain on this construction risk:

7                   [A]bsolutely getting off - she feels gave us plenty of time. . . *she says she'd get*  
 8                   *fired.* Could give us 30 more days but that's it.<sup>16</sup>

9           St. Paul Guardian extended its policy for one month, from January 4, 2000 to February 4,  
 10           2000, for an additional liability premium of \$1,099.<sup>17</sup> By the time the extension ran Ms. Jacks  
 11           had procured replacement construction liability coverage for Hebert Construction and MVLLC  
 12           with Admiral Insurance Company ("Admiral"). The Admiral policy incepted February 4, 2000  
 13           and renewed for two years, ending on February 4, 2003.<sup>18</sup> Its first year liability premium was  
 14           \$18,000.<sup>19</sup> Each Admiral policy contained a "specified operations exclusion" that barred  
 15           coverage for residential construction, but in the first year the exclusion carved out an exception  
 16           specifically for construction of the Meadow Valley condominiums:

17                   This exclusion does not apply to construction of Meadow Valley, LLC a 72 unit  
 18                   condominium complex.<sup>20</sup>

19           <sup>15</sup> Jacks Decl. ¶ 17 Exh. 1 (emphasis added).

20           <sup>16</sup> Andersen Decl. Exh. 10.

21           <sup>17</sup> Andersen Decl. Exh. 11.

22           <sup>18</sup> Andersen Decl. Exhs. 12, 13.

23           <sup>19</sup> Andersen Decl. Exh. 12. See also Jacks Decl. ¶ 17.

24           <sup>20</sup> The Admiral policy provided by endorsement:

25                   **SPECIFIED OPERATIONS EXCLUSION**

26           This endorsement modifies insurance provided under the following:

                  COMMERCIAL GENERAL LIABILITY COVERAGE PART

                  PRODUCTS/COMPLETED OPERATIONS LIABILITY COVERAGE PART

          This insurance does not apply to any "bodily injury", "property damage", "personal or  
 advertising injury" liability arising out of any residential construction including  
 condominiums, townhomes, single and multiple family dwellings conducted by or for you.

1 Like the St. Paul Guardian policy, and unlike the St. Paul Fire policy (below), the  
2 Admiral policy did not insure either condominium associations or unit owners.<sup>21</sup>

3 **3. MVLLC's condominium association liability insurance**

4 **a. Condominium associations are required to have liability insurance**

5 The first unit at Meadow Valley condominiums closed on September 9, 1999.<sup>22</sup> MVLLC  
6 managing member Roger Hebert, who with his older brother Henry had been involved as an  
7 owner in the development of at least four other condominiums before Meadow Valley, testified  
8 he knew condominium associations should have their own liability coverage, which coverage  
9 should ideally be in place before the first unit closes.<sup>23</sup>

10 Mr. Hebert's understanding comports with the association insurance requirements of both  
11 the Washington Condominium Act and the Condominium Declaration for Meadow Valley, A  
12 Condominium ("Declaration"). The Condominium Act and the Declaration each require that the  
13 condominium association have liability coverage in place "at the time of the first conveyance of  
14 a unit to a person other than a declarant," and that unit owners be named as insureds.<sup>24</sup>

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15 *This exclusion does not apply to construction of Meadow Valley, LLC a 72 unit*  
16 *condominium complex.*

17 [Emphasis added.] *Id.*

18 <sup>21</sup> *Id.*

19 <sup>22</sup> Andersen Decl. Exh. 14.

20 <sup>23</sup> Hebert Dep. p. 20, ll. 19–22, Andersen Decl. Exh. 7.

21 <sup>24</sup> RCW 64.34.352 requires that, no later than the date the first unit is conveyed, a  
22 condominium association carry liability coverage for property damage arising out of the "use, ownership,  
23 or maintenance" of the common elements:

24 (1) Commencing not later than the time of the first conveyance of a unit to a person  
25 other than a declarant, the association *shall* maintain, to the extent reasonably available:

26 \* \* \*

(b) *Liability insurance*, including medical payments insurance, in an amount  
determined by the board of directors but not less than the amount specified in the  
declaration, covering all occurrences commonly insured against *for . . . property damage*  
arising out of or in connection with the use, ownership, or maintenance of the common  
elements (emphasis added).

\* \* \*

Accordingly, on October 21, 1999, shortly after the first unit sold, Marjorie Syria, the Hebert Construction employee responsible for procuring insurance for all the Hebert brothers' legal entities, contacted broker Edith Jacks to secure association coverage for the condominium.<sup>25</sup> Ms. Jacks asked Ms. Syria to send her the Declaration and Bylaws so Marsh could solicit quotes for this necessary coverage.<sup>26</sup>

**b. MVLLC applies for insurance as a condominium association**

There was some delay in receiving the documents, but three months later Martha Washburn at Marsh on behalf of MVLLC electronically submitted a 52-page insurance application to St. Paul Fire. The application stated that the insured would be MVLLC, and the "nature of [its] business" was "6513 - apartment bldg. operators condominium association."<sup>27</sup> In response to the question, "What business activities or operations has the insured been involved in that they are not involved in currently?" MVLLC answered "none."<sup>28</sup>

The GL hazard detail Ms. Washburn prepared described the insured risk as "condominiums — residential — (association risk only)," with an exposure basis of "u = unit per unit," annual exposure of "78 [units]" and class code "62003."<sup>29</sup> St. Paul Fire underwriter Scott Gilliland, who underwrote this policy, testified the class code "62003" is an insurance-industry wide code meaning a condominium association.<sup>30</sup> After reviewing what he believed was a perfectly acceptable condominium association risk, Mr. Gilliland faxed a quote to Marsh

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(3) Each unit owner is an insured person under the policy with respect to liability arising out of the owner's interest in the common elements or membership in the association . . . .

<sup>25</sup> Jacks Decl. Exh. 2, and Jacks Decl. ¶¶ 7-9 and 12.

<sup>26</sup> Jacks Decl. ¶ 9.

<sup>27</sup> Andersen Decl. Exh. 15. Before providing a quote, St. Paul Fire clarified that the risk was a condominium association, not an apartment. June 8, 2006 Deposition Transcript of Scott Gilliland ("Gilliland Dep."), p. 60, 11.8-13, p. 61, 11. 2-13, Andersen Decl. Exh. 16.

<sup>28</sup> Andersen Decl. Exh. 15.

<sup>29</sup> Andersen Decl. Exh. 17.

<sup>30</sup> Gilliland Dep. p. 112, ll.15-25, p. 113, ll. 1-10; Andersen Decl. Exh. 16.

1 showing an annual liability premium of \$622 for this coverage. On Ms. Syria's directive,  
2 Ms. Jacks bound this condominium association coverage:

3 [A]ttached is our proposal for this *Condo Association Insurance*. Per your request  
4 we have bound this coverage effective 4-18-00 for 36 months policy with monthly  
payments of \$927 (financing without interest will be directly through AFCO) . . <sup>31</sup>

5 **c. The St. Paul Fire "community association" liability policy**

6 St. Paul Fire issued policy no. BC01900003 policy for a three year term, from April 15,  
7 2000 — April 15, 2003. (A "BC" prefix meant the insured was a condominium association or an  
8 apartment complex; a "KK" prefix, as in the St. Paul Guardian policy, meant the insured was a  
9 contractor or developer.)<sup>32</sup> The named insured on the declaration page is "Meadow Valley,  
10 LLC." The Association was added (retroactively) as a named insured on March 06, 2001.<sup>33</sup> The  
11 primary liability portion of the policy, form no. 41326, is entitled "Community Association  
12 Package General Liability Protection." This is the form St. Paul Fire always used when the  
13 insured was a condominium association.<sup>34</sup>

14 The introductory paragraph of form 41326 states: "This insuring agreement provides  
15 general liability protection for your *association activities*."<sup>35</sup>

16 On the same form, the "Who is Protected Under This Agreement" provision includes:

17 The "association" and its "directors and executive officers."

18 "Unit owners," but "only for the ownership, maintenance, or repair of your  
[i.e., the association's] premises."

19 "Developers," but "only for the ownership, maintenance, or repair of that  
20 part of your premises [not] solely owned or occupied by that developer."<sup>36</sup>

21 <sup>31</sup> Andersen Decl. Exh. 18; Exh. 19. See also Jacks Decl. ¶ 15.

22 <sup>32</sup> Gilliland Dep. p. 104, ll. 7-16, 23-25, p. 105, l.1; Andersen Decl. Exh. 16.

23 <sup>33</sup> Andersen Decl. Exh. 20 at bates no. SPT00718.

24 <sup>34</sup> Gilliland Dep. p. 105, l. 25, p. 106, ll. 1, 11-16; Andersen Decl. Exh. 16.

25 <sup>35</sup> Andersen Decl. Exh. 20 at bates no. SPT00780.

26 <sup>36</sup> *Id.* at bates no. SPT00784. The Condominium Declaration required the Association to  
have liability insurance under which the declarant (MVLLC) and unit owners were listed as insureds.  
Declaration, Art. 21.3. It also required the declarant to be responsible for "maintenance [and] repair" of



1 And, on the same form, the insuring agreement states:

2 We'll pay amounts any protected person is legally required to pay as  
3 damages for covered bodily injury or property damage that:

4 happens while this agreement is in effect; and

5 is caused by an occurrence.

6 MVLLC paid the premiums for this policy.<sup>37</sup> By summer 2002, when association control  
7 passed from MVLLC to the unit owners, responsibility for paying the premiums for this policy  
8 passed to them as well.<sup>38</sup> (The unit owners would not have agreed to pay premiums on a  
9 construction policy issued to a developer.)

10 The St. Paul Fire policy issued to MVLLC was in effect at the same time as the Admiral  
11 policy issued to MVLLC *that specifically provided construction liability coverage for the*  
12 *Meadow Valley condominiums* — at 30 times the premium.<sup>39</sup>

13 **d. MVLLC continues to represent that it is the association**

14 Even after the policy had been issued, MVLLC continued to represent to St. Paul Fire  
15 that it was, or was acting as, the condominium association. In MVLLC's Quarterly Checklist  
16 (submitted in lieu of an audit), MVLLC represented that it had no "new or discontinued  
17 operations" and was not "planning any changes in [its] operations."<sup>40</sup>

18 And, in the November 8, 2000 loss control services report prepared for St. Paul Fire by a  
19 consultant who walked the property to report back to Mr. Gilliland about risks and potential

20 the property. *Id.* at Art. 10.4. This dovetails exactly with the St. Paul Fire policy developer coverage,  
21 which under policy form no. 41326 is limited to the ". . . maintenance or repair" of the property.

22 <sup>37</sup> Andersen Decl. Exh. 21.

23 <sup>38</sup> *Id.* See also, RCW 64.34.312, which states:

24 (1) Within 60 days after the termination of the period of declarant control . . . the declarant  
25 shall deliver to the association all property of the unit owners and of the association held  
26 or controlled by the declarant, including but not limited to . . . .

\* \* \*

(k) Insurance policies or copies thereof for the condominium and association[.]

<sup>39</sup> See n.18, *supra*. The St. Paul Fire liability premium was \$601 for each of the three years  
of coverage; the Admiral premium, \$18,000 the first year and higher the second and third.

<sup>40</sup> Andersen Decl. Exh. 22.



1 hazards, the consultant indicated his contact at the project was MVLLC managing member  
 2 Roger Hebert, and that MVLLC was acting as the project's condominium association until a true  
 3 association could be formed.<sup>41</sup> No one ever told St. Paul Fire the association had in fact been  
 4 formed fourteen months before this policy was issued.<sup>42</sup>

5 When Mr. Gilliland prepared his underwriting analysis he relied on this loss control  
 6 services report, specifically the representation (presumably from Roger Hebert) that MVLLC  
 7 was acting as the association, when he wrote the insured "is a condominium association."

8 *Insured is a condominium association composed of 16 frame buildings with 78*  
 9 *total units. Location was constructed in 2000 and at date of last visit 50% of units*  
 10 *were occupied with others filling up fast. Building contractor is still the sole*  
 11 *association until the unit owner association is formed.*<sup>43</sup>

12 The "Financials" section of Mr. Gilliland's underwriting analysis similarly states, "Brand  
 13 new and unit owner assoc. not formed yet. No financial info to receive."<sup>44</sup>

14 And the "Operations — Nature of Business" section reflects the same information:

15 [M]ulti-unit townhouse development consisting of 78 units in 16 buildings (plus  
 16 clubhouse) with about 50% of the units sold to date. *The association has not been*  
 17 *developed yet and the contractor is the sole association.*<sup>45</sup>

18 Finally, in the "General Liability Narrative," Mr. Gilliland discusses the premises liability  
 19 nature of the liability risks. Notably, his narrative includes no reference to construction risks:

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20 <sup>41</sup> Andersen Decl. Exh. 23.

21 <sup>42</sup> Gilliland Dep. p. 53, ll. 1-14; Andersen Decl. Exh. 16. Although the Association was  
 22 incorporated on February 24, 1999, a year before MVLLC applied for condominium association coverage  
 23 with St. Paul Fire, MVLLC's application and two consistent post-policy representations reflected its  
 24 position that it either was the association or was acting as the association until a true association could be  
 25 formed. Even MVLLC managing member (and Association president) Roger Hebert could not explain  
 26 why MVLLC applied for insurance as the condominium association when an actual association already  
 existed, except to surmise it was because MVLLC controlled the association. Hebert Dep. p. 30, ll. 8-22,  
 p. 52, ll. 13-25, p. 53, ll. 1-6; Andersen Decl. Exh. 16.

<sup>43</sup> Andersen Decl. Exh. 24; Gilliland Decl. ¶ 14; Gilliland Dep. p. 66, ll. 4-25, p. 67,  
 ll. 20-25, p. 68, ll. 11-13; Andersen Decl. Exh. 16.

<sup>44</sup> *Id.* (emphasis added).

<sup>45</sup> Andersen Decl. Exh. 23 (emphasis added).

1 The premises have asphalt drives, concrete walks for the access to the units and  
 2 concrete drives. There is security gate across the front. The units are landscaped  
 3 and have carpet throughout the units and linoleum in the kitchen, bathroom and  
 laundry rooms. There are stairs with wood railings. The bathtubs have a non-skid  
 surface. There were no trip and fall hazards observed.<sup>46</sup>

4 In other words, the largest risk St. Paul Fire contemplated in issuing this liability policy  
 5 was that someone would trip and fall — an exposure wholly in line with a condominium  
 6 association risk, but out of line with a developer's construction risk. In all his years as a St. Paul  
 7 underwriter, Mr. Gilliland never wrote a construction risk. He would not have written this risk if  
 8 MVLLC had applied for coverage as a developer.<sup>47</sup>

#### 9 **4. Lawsuits against MVLLC and Hebert Construction**

10 In August 2003, just before the statute of limitations for condominium construction  
 11 defect claims ran, the Association conducted its first professional inspection of the project to  
 12 determine whether construction defects existed. The resulting findings led to the Complaint  
 13 styled *Meadow Valley Owners Association v. MVLLC*.<sup>48</sup> The Association alleged, among other  
 14 things, that certain defects in the construction of the condominium buildings caused water  
 15 intrusion through the building envelope and resulting damage.<sup>49</sup>

16 The Association's lawsuit and resulting settlement negotiations were focused on the  
 17 Meadow Valley defendants' alleged liability under the implied warranty of quality construction  
 18 set forth in Washington's Condominium Act, RCW 64.34.445. The Association's construction  
 19 expert, Art Schroeder of Pacific Engineering Technologies ("PET") and its architectural expert,  
 20 Studio Meng Strazarra, prepared reports regarding, and PET prepared a scope of recommended  
 21 repairs for, alleged defects at the Meadow Valley Condominiums. The result was a scope of  
 22 repair for everything from inconsistent spacing of handrail brackets to insufficient attic

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23 <sup>46</sup> See *id.*

24 <sup>47</sup> Gilliland Dep. p. 103, ll. 24-25, p. 104, ll. 1-6, 17-20; Andersen Decl. Exh. 16.

25 <sup>48</sup> Andersen Decl. Exh. 25.

26 <sup>49</sup> *Id.*

insulation.<sup>50</sup> The Association's cost estimator, Charter Construction, prepared an item-by-item cost estimate for the PET scope of repair.<sup>51</sup>

### 5. St. Paul defends its insureds

St. Paul Fire issued condominium association liability policy no. BC01900003 to MVLLC, effective April 15, 2000 — April 15, 2003 (the Association was later added to this policy by retroactive endorsement). St. Paul Guardian issued construction liability policy no. KK08400026 to Hebert Construction and MVLLC, effective January 4, 1999 — February 4, 2000.

MVLLC tendered the Association's lawsuit to St. Paul Fire on or about September 30, 2003. St. Paul Fire promptly appointed Francis Floyd of the law firm of Floyd & Pfleuger to represent MVLLC and member Roger Hebert. Mr. Floyd entered his appearance on October 7, 2003. After completing its initial coverage analysis, St. Paul Fire sent a letter to MVLLC and Roger Hebert on October 29, 2003, agreeing to defend MVLLC and Hebert subject to a complete reservation of rights to later deny coverage on any basis, whether or not identified in that letter.<sup>52</sup>

MVLLC later filed a third-party complaint against Hebert Construction, and Hebert Construction tendered that claim to St. Paul as well.<sup>53</sup> On April 27, 2004, Fidelity & Guaranty (a St. Paul predecessor company) agreed to defend Hebert Construction under a complete reservation of rights.<sup>54</sup> St. Paul retained Steven Jager of Lee Smart Cook Martin & Patterson to represent Hebert Construction a month before it even issued its reservation of rights letter.<sup>55</sup>

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<sup>50</sup> Andersen Decl. Exh. 26.

<sup>51</sup> Andersen Decl. Exh. 27.

<sup>52</sup> Andersen Decl. Exh. 28.

<sup>53</sup> Andersen Decl. Exh. 29.

<sup>54</sup> Andersen Decl. Exh. 30.

<sup>55</sup> Andersen Decl. Exh. 31.

6. **St. Paul Fire tells MVLLC this is an association policy and doesn't apply**

On May 5, 2004, Craig Yeary, Regional Director of the Major Case Unit, Construction Defect Claims for St. Paul, took over as the adjuster for the MVLLC claim.<sup>56</sup> Upon review of the St. Paul Fire policy under which MVLLC had tendered and St. Paul Fire had been defending, Mr. Yeary determined the policy may have been issued as a condominium association liability policy, not as a policy that covered developer construction risks, and so might not apply.<sup>57</sup> He ordered the underwriting materials for this policy and further investigated.

Upon review of the underwriting file, Mr. Yeary determined that MVLLC had applied for coverage as a condominium association, that St. Paul Fire had issued the policy to MVLLC as a condominium association, and that the policy covered only condominium association risks. Mr. Yeary therefore determined that St. Paul Fire owed no coverage to MVLLC under this policy.<sup>58</sup> At the same time, he knew no other insurer had stepped up to defend MVLLC.<sup>59</sup>

On July 6, 2004, two months after he was assigned this claim, Mr. Yeary sent the policy and other materials to coverage counsel to verify or rebut his conclusion.<sup>60</sup> *The same day*, he sent a letter to MVLLC notifying it that the St. Paul Fire policy did not provide coverage for construction defect claims against it and requesting information about other insurance:

As you are aware, the coverage issued by the St. Paul Fire and Marine Insurance Company under policy number BC01900003 provides coverage to both the Meadow Valley Owners Association and Meadow Valley LLC. The policy is subject to the Condominium Association Commercial General Liability Protection Form # 41326 (3/98). You will note that in the insuring agreement found at the top of page 1 of the form it states:

This insuring agreement provides general liability protection for your association activities.

<sup>56</sup> Andersen Decl. Exh. 32.

<sup>57</sup> June 1, 2006 Deposition Transcript of Craig Yeary ("Yeary Dep."), p. 75, ll. 2-25; Andersen Decl. Exh. 33.

<sup>58</sup> *Id* at p. 76, ll. 21-25, p. 77, ll. 1-10; p. 113, ll. 5-22; Andersen Decl. Exh. 33.

<sup>59</sup> *Id* at p. 114, ll. 4-13; Andersen Decl. Exh. 33.

<sup>60</sup> *Id* at p. 76, ll. 9-19; Andersen Decl. Exh. 33.1.

1 There are, of course, limitations and exclusions which apply to that protection.  
 2 As a result, this agreement should be read carefully to determine the extent of the  
 coverage provided to you and other protected persons.

3 It appears that this policy does not provide coverage to Meadow Valley LLC for  
 4 claims made against it for construction defects. We have referred the matter out  
 to coverage counsel for further review. I will be back in touch with you with  
 5 regards to our coverage position as soon as counsel has had an opportunity to  
 review the matter. It is imperative that you report this matter to any other insurer  
 that might provide coverage to the Meadow Valley LLC as soon as possible.<sup>61</sup>

6 I will be back in touch with you shortly as to the coverage position of the St. Paul  
 7 Fire and Marine Insurance Company.

8 (Emphasis in original.)<sup>62</sup>

9 It does not appear Mr. Yeary received any type of reply from MVLLC. He did, however,  
 10 continue to investigate on his own, and later that summer discovered MVLLC was an insured  
 11 under the St. Paul Guardian policy issued to Hebert Construction. As a result, on September 22,  
 12 2004, Mr. Yeary wrote MVLLC withdrawing from the defense and denying coverage on behalf  
 13 of St. Paul Fire, and simultaneously informing MVLLC that St. Paul Guardian under a  
 14 reservation of rights would immediately assume MVLLC's defense.<sup>63</sup>

15 Thus, although MVLLC knew on July 6, 2004 — two and a half months before St. Paul  
 16 Fire officially denied coverage — that this policy did not apply to the construction claims against  
 17 it, it continued to receive the benefit of a defense under the policy until St. Paul (not MVLLC!)  
 18 found other coverage under which to provide it a defense. From the time MVLLC was sued to  
 19 the time it settled this matter, St. Paul always and with no interruption defended it.<sup>64</sup>

## 20 **7. The underlying covenant judgment settlement**

21 During a year and a half of litigation, during which MVLLC and Hebert Construction  
 22 were completely defended by St. Paul Fire or St. Paul Guardian, the Association's settlement

23  
 24 <sup>61</sup> Andersen Decl. Exh. 34.

<sup>62</sup> *Id.*

25 <sup>63</sup> Andersen Decl. Exh. 35.

26 <sup>64</sup> Yeary Dep. p. 115, ll. 18-21; Andersen Decl. Exh. 33.

demands consistently exceeded the value of the claims St. Paul believed could possibly be covered by its policies. Because of this impasse, a cash settlement was never possible.

In April 2005, at the third mediation in the underlying action, the Association, MVLLC and Hebert Construction entered into a \$7,200,000 covenant judgment settlement comprised of \$4,800,000 in repair related costs and half that amount (\$2,400,000) in attorney's fees. The Association relied on the Condominium Act as the basis for its attorney's fee claim.<sup>65</sup>

At the reasonableness hearing, the trial court found the attorney's fee award too high, reduced the entire settlement to \$6,400,000 (\$4,800,000 in repair-related costs and \$1,600,000 in attorney's fees) and entered judgment on the reduced amount.<sup>66</sup> The court at the hearing made a point to say that MVLLC and Hebert Construction had received outstanding defenses from the attorneys St. Paul had appointed to represent their interests.<sup>67</sup> And, neither MVLLC or Hebert Construction ever alleged they were dissatisfied with the defense St. Paul provided, or the results obtained by that defense.

## **B. Argument**

Washington law governs this diversity matter.<sup>68</sup>

### **1. The St. Paul Fire policy does not provide coverage to MVLLC**

Interpretation of an insurance contract is a question of law properly determined on summary judgment. *American Star v. Grice*, 121 Wn.2d 869, 854 P.2d 622 (1993). Summary judgment may be granted against a party that fails to adduce facts sufficient to establish the

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<sup>65</sup> Andersen Decl. Exh. 35.

<sup>66</sup> St. Paul has appealed entry of this judgment.

<sup>67</sup> Andersen Decl. Exh. 36.

<sup>68</sup> In a suit in federal court pursuant to diversity jurisdiction, the court applies the choice of law rules of the state in which it sits. *Orange St. Partners v. Arnold*, 179 F.3d 656, 661 (9th Cir. 1999). Under Washington law, the parties' rights under an insurance policy are determined by the law of the state with the most significant contacts with the policy. *Dairyland Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 41 Wn. App. 26, 31, 701 P.2d 806 (1985), *rev. den.*, 104 Wn.2d 1016 (1985). Here, Washington law controls because MVLLC's headquarters are here and it negotiated and placed its insurance here.

1 existence of any element essential to the party's claim, and upon which that party will bear the  
 2 burden of proof at trial. *Nebraska v. Wyoming*, 507 U.S. 584, 590, 113 S. Ct. 1689 (1993).

3 Washington has adopted the context rule for interpreting contracts. *Berg v. Hudesman*,  
 4 115 Wn.2d 657, 667, 801 P.2d 222 (1990); *Lynott v. National Union Fire*, 123 Wn.2d 678, 871  
 5 P.2d 146 (1994) (applying context rule to insurance contracts). This means that, without a  
 6 predicate showing of ambiguity, a court may consider not only the language of the agreement at  
 7 issue but also all the surrounding circumstances leading to its formation. *Berg*, 115 Wn.2d at  
 8 667. The only limitations are that extrinsic evidence which contradicts the plain language of the  
 9 agreement or shows only one party's subjective understanding of what was to be covered, is not  
 10 admissible. *Id.*; *Lynott*, 123 Wn.2d at 684; *Findlay v. United Pacific*, 129 Wn.2d 368, 917 P.2d  
 11 116 (1996).

12 As the *Berg* court explained:

13 May we say here that we are mindful of the general rule that parol evidence is not  
 14 admissible for the purpose of adding to, modifying, or contradicting the terms of a  
 15 written contract, in the absence of fraud, accident, or mistake. But, as stated in  
 16 *Olsen v. Nichols*, 86 Wash. 185, 149 P. 668 [(1915)], *parol evidence is admissible*  
 17 *to show the situation of the parties and the circumstances under which a written*  
 18 *instrument was executed, for the purpose of ascertaining the intention of the*  
 19 *parties and properly construing the writing. Such evidence, however, is admitted,*  
 20 *not for the purpose of importing into a writing an intention not expressed therein,*  
 21 *but with the view of elucidating the meaning of the words employed.* Evidence of  
 22 this character is admitted for the purpose of aiding in the interpretation of what is  
 23 in the instrument, and not for the purpose of showing intention independent of the  
 24 instrument. It is the duty of the court to declare the meaning of what is written,  
 25 and not what was intended to be written. If the evidence goes no further than to  
 26 show the situation of the parties and the circumstances under which the  
 instrument was executed, then it is admissible.

115 Wn.2d at 669 (emphasis added).

**a. The St. Paul Fire policy must be construed as a whole**

23 An insurance policy is construed as a whole, with the policy given a fair, reasonable, and  
 24 sensible construction as would be given to the contract by the average person purchasing  
 25 insurance. *Panorama Village v. Allstate*, 144 Wn.2d 130, 138, 31 P.3d 628 (2001). The policy  
 26



1 should be read so that each clause is given force and effect. *Overton v. Consolidated*, 145 Wn.2d  
 2 417, 38 P.2d 322 (2002). It must be viewed in its entirety; a phrase cannot be interpreted in  
 3 isolation. *Allstate v. Peasley*, 131 Wn.2d 420, 424, 932 P.2d 1244 (1997). MVLLC argues it is  
 4 entitled to construction coverage under the St. Paul Fire policy because the policy is a general  
 5 liability policy under which MVLLC is a named insured against whom damages for property  
 6 damage are sought. But focusing on just the two lines of the insuring agreement, as this  
 7 argument does, while ignoring all the other component parts of association liability form  
 8 no. 41326, disregards *Overton* and *Peasley*, above, and is contrary to the law.

9 The structure of an insurance policy provides “an important objective source of meaning  
 10 and intent.” *Findlay v. United Pacific*, 129 Wn.2d 368, 377, 917 P.2d 116 (1996). Liability  
 11 form no. 41326 is entitled “Community Association Package General Liability Protection.” Its  
 12 introductory statement reads: “[t]his insuring agreement provides general liability protection for  
 13 your association activities.”<sup>69</sup> By contrast, the liability form no. 47175 for the St. Paul Guardian  
 14 policy is entitled “Contractors General Liability Protection,” and its introductory statement reads:  
 15 “[t]his insuring agreement provides general liability protection for your business.”<sup>70</sup>

16 Under the St. Paul Fire policy, the association and its directors and officers are insureds.  
 17 Unit owners and developers are also insureds, but only for the “ownership, maintenance, or  
 18 repair” of [the common elements] — language that tracks almost exactly with the Condominium  
 19 Act and Declaration liability insurance requirements for a condominium association.<sup>71</sup> This  
 20 language is typical of condominium association liability policies. *See, e.g., First Londonderry v.*  
 21

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22  
 23 <sup>69</sup> Andersen Decl. Exh. 20 at bates no. SPT00780.

24 <sup>70</sup> Andersen Decl. Exh. 9, at bates no. SPT00927.

25 <sup>71</sup> The Condominium Act requires condominium associations carry liability coverage for  
 26 the “use, ownership, or maintenance” of the common elements. RCW 64.34.352(1)(b). The Declaration  
 requires the Meadow Valley condominium association carry liability coverage for the “operation,  
 maintenance, and use” of the common elements. Andersen Decl. Exh. 3 § 21.3.

1 CNA, 140 N.H. 592, 669 A.2d 232 (1995). But, under the St. Paul Guardian and Admiral  
2 policies, associations, their directors and officers, unit owners and developers are not insureds.<sup>72</sup>

3 Where the St. Paul Fire liability policy was written on a community association form, no  
4 other policy provided association coverage during the St. Paul Fire policy period, and the  
5 contemporaneous Admiral policy provided construction coverage to MVLLC *specifically for this*  
6 *project*, common sense dictates that the policy should be interpreted as providing condominium  
7 association coverage only. *See Morrison Fruit v. Scarlett Fruit*, 72 Wn. App. 687, 693, 865 P.2d  
8 570 (1994) (when construing an insurance policy a court should use common sense).

9 **b. MVLLC is the named insured because it said it was the association**

10 The oddest thing about this case is that MVLLC applied for insurance as a condominium  
11 association when, in fact, a condominium association already existed.<sup>73</sup> Roger Hebert can't  
12 explain it.<sup>74</sup> No one seems to know why it happened. Maybe it was because when MVLLC  
13 applied for this policy it controlled the association. It still owned most of the units.<sup>75</sup> Its  
14 members were the only officers of the association from February 24, 1999, when the association  
15 was formed, to February 7, 2002, when MVLLC ceded association control to the unit owners.<sup>76</sup>  
16 Maybe no one realized an association was already in existence, and Ms. Syria, the Hebert  
17 Construction employee responsible for procuring insurance for the Hebert brothers' various legal  
18 entities (including the condominium associations they would create after the buildings were  
19 done) thought she was doing the right thing by naming the developer as the *de facto* association.

20 Odd or not, the fact remains that MVLLC applied for insurance, and St. Paul Fire issued  
21 it insurance, as a condominium association. Underwriter Scott Gilliland testified that his  
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23 <sup>72</sup> Andersen Decl. Exhs. 9, 12.

24 <sup>73</sup> Andersen Decl. Exh. 5.

25 <sup>74</sup> See n.42, *supra*.

26 <sup>75</sup> See Andersen Decl. Exh. 15 at bates no. SPT01121.

<sup>76</sup> Andersen Decl. Exh. 6.

department, middle commercial accounts, never wrote construction coverage. In fact, in all his time at St. Paul he has never issued a single construction policy.<sup>77</sup> He issued this policy solely because MVLLC on its application represented itself to be the condominium association.<sup>78</sup> And, after the policy was issued, MVLLC continued to represent that it was a condominium association or acting as one until one was formed.<sup>79</sup> Based on these representations, St. Paul Fire had no reason to believe it had issued a policy to anyone other than a condominium association.

**c. Extrinsic evidence “elucidates the meaning of the words employed”**

Besides the policy itself and the parallel association insurance requirements in the Condominium Act and the Declaration, five independent pieces of extrinsic evidence corroborate MVLLC and St. Paul Fire’s manifested mutual understanding of the type of coverage afforded MVLLC under this policy, and elucidate the meaning of the words employed.

**Course of dealing.** The course of dealing between St. Paul and MVLLC shows MVLLC knew five months before this policy even inception that St. Paul was non-renewing the St. Paul Guardian policy because it wanted off all residential construction risks.<sup>80</sup>

**The application.** In its insurance application MVLLC described itself as a condominium association, said it was not a contractor, rated its liability hazard “condominiums — residential — (association risk only)” and requested its coverage be rated on a per unit basis (not, as typical with construction risks, on sales or payroll). Scott Gilliland issued this policy because he understood, based on the application, that the policy was for a condominium association.<sup>81</sup> The court may consider the underwriting decisions of an insurer in determining the intent of the parties. *Kelly v. Aetna Cas. & Sur. Co.*, 100 Wn.2d 401, 405, 670 P.2d 267 (1983).

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<sup>77</sup> Gilliland Dep. p. 104, Andersen Decl. Exh. 26.

<sup>78</sup> Gilliland Decl. ¶ 12.

<sup>79</sup> Andersen Decl. Exhs. 15, 22.

<sup>80</sup> Jacks Decl. Exh. 2.

<sup>81</sup> Gilliland Decl. ¶¶ 13-14.

1       **The premium.** St. Paul Fire submitted a \$622 annual liability premium bid to MVLLC  
 2 broker Marsh before the policy was issued.<sup>82</sup> When MVLLC saw this bid it already had  
 3 contemporaneous construction liability coverage with Admiral for which it paid \$18,000 per  
 4 year.<sup>83</sup> And it had paid \$12,934 a year for the earlier St. Paul Guardian policy. The premium  
 5 MVLLC paid for the St. Paul Fire policy was just *three percent* of the premium it paid for the  
 6 contemporaneous Admiral policy. Put another way, Admiral's premium was 30 times St. Paul's.

7       *Aetna v. Kent*, 85 Wn.2d 942, 540 P.2d 1383 (1975), has almost identical facts. In that  
 8 case, as here, the insured had two liability policies, a contractor's policy and a contemporaneous  
 9 auto policy. The insured paid \$41 in premiums for the contractor's policy and \$1,294 for the  
 10 auto policy — and, like here, the first policy premium was three percent of the second, and the  
 11 second 30 times the first. The *Kent* court found the remarkable premium disparity “clear  
 12 evidence” the two policies were intended to provide mutually exclusive coverage, with the  
 13 premium charged accordingly:

14       Moreover, the gross disparity in premium costs is clear evidence the contractor  
 15 and automobile liability policies were not intended to provide the same coverage  
 16 but rather were intended to provide mutually exclusive coverage. In the  
 17 automobile policy, coverage was provided for each person sustaining bodily  
 18 injury up to \$25,000, with the maximum for each occurrence of \$100,000. The  
 19 annual premium charged was \$1,294. In the contractor's policy, however, the  
 20 coverage was \$250,000 for bodily injury for each person covered by the policy  
 21 and \$500,000 for each occurrence. The annual premium charged was \$41.  
 22 Clearly, Aetna did not intend by the contractor's policy to provide \$250,000 of  
 automobile liability coverage for 41/1294 of the premium costs of the automobile  
 liability coverage contained in the automobile policy. Similarly, it is  
 unreasonable to believe that Kent in purchasing the contractor's policy for \$41  
 reasonably expected thereby to obtain automobile liability coverage for which he  
 paid \$1,294. *It is more reasonable to believe the parties intended each policy to  
 provide mutually exclusive coverage and the premium was charged accordingly.*

23  
 24       <sup>82</sup> The actual premium was lower — \$601 a year for three years.

25       <sup>83</sup> The St. Paul Fire policy was effective April 15, 2000 - April 15, 2003. The Admiral  
 26 policy was effective February 4, 2000 - February 4, 2003. The Admiral annual liability premiums were  
 \$18,000, \$21,600 and \$50,000, respectively. Andersen Decl. Exhs. 12 and 13.

1 *Aetna v. Kent*, 85 Wn.2d at 947 (emphasis added). An insurer is entitled to contractually limit its  
 2 risk by limiting coverage to situations contemplated at the time of computing premiums. *Kelly v.*  
 3 *Aetna Cas. & Sur. Co.*, 100 Wn.2d 401, 404, 670 P.2d 267 (1983). St. Paul Fire should not be  
 4 penalized for doing exactly that.

5 Finally, it would make no sense for the unit owners who took over paying premiums for  
 6 this policy in 2002 to do so since that would mean they were paying for MVLLC's developer  
 7 risks.

8 **MVLLC's post-policy representations.** After the policy began, MVLLC submitted a  
 9 quarterly checklist to St. Paul Fire that stated its business (being a condominium association) had  
 10 not changed, and there were no plans for it to change.<sup>84</sup> In November 2000, a loss control  
 11 consultant hired by St. Paul Fire walked the Meadow Valley property. The consultant's report  
 12 indicated his contact at the property was MVLLC managing member Roger Hebert, and  
 13 confirmed (presumably from speaking with Mr. Hebert) that MVLLC was acting as the  
 14 condominium association until a true association could be formed.<sup>85</sup> Scott Gilliland relied upon  
 15 this information to assess the continued appropriateness of this risk.<sup>86</sup>

16 **The broker's and underwriter's corroborated understanding.** In *Lynott v. National*  
 17 *Fire*, 123 Wn.2d 678, 684, 871 P.2d 146 (1994), the court held that negotiations for placement of  
 18 an insurance policy are admissible under the "context rule" to interpret the policy. Edith Jacks  
 19 and Scott Gilliland, who negotiated this policy, have both unequivocally testified the policy was  
 20 intended to provide association risk coverage to MVLLC as the condominium association, not  
 21 construction risk coverage to MVLLC as a condominium developer.<sup>87</sup>

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22 <sup>84</sup> Andersen Decl. Exh. 22.

23 <sup>85</sup> Andersen Decl. Exh. 15.

24 <sup>86</sup> Gilliland Dep. pp. 54, ll. 5-17, p. 101, ll. 10-23, p.102, ll. 7-21, p. 103, ll. 24-25, p.104,  
 ll. 1-6; at Andersen Decl. Exh. 16.

25 <sup>87</sup> See Jacks Decl. ¶ 17, Gilliland Decl. ¶¶13-14 and Gilliland Dep. p. 103, ll. 18-25, p. 104,  
 26 ll. 1-6; Andersen Decl. Exh. 16.

1 All the evidence in this matter is consistent with the parties' mutual intent to insure  
2 condominium association risks, and inconsistent with a mutual intent to insure construction risks.  
3 Summary judgment for St. Paul Fire on this issue is appropriate.

4 **2. St. Paul Fire and St. Paul Guardian did not act in bad faith**

5 The Meadow Valley defendants have alleged that St. Paul Fire and St. Paul Guardian  
6 committed bad faith by (1) failing to raise the "association risk only" coverage defense in  
7 St. Paul Fire's original reservation of rights letter, and (2) failing to settle the underlying action  
8 filed against the Meadow Valley defendants. As to the first allegation, MVLLC seeks to estop  
9 St. Paul Fire from relying upon the "association risk only" defense. But in order to do so, it  
10 must establish that St. Paul Fire acted in bad faith to MVLLC's detriment, or that MVLLC was  
11 prejudiced by the late assertion of the defense, which it cannot do.

12 As to the second allegation, St. Paul Fire and St. Paul Guardian are in good faith  
13 contesting coverage and there can be no duty to make any indemnity settlement payments unless,  
14 and only to the extent that, the coverage dispute is resolved in Meadow Valley defendants' favor.  
15 There is, therefore, no basis for a bad faith failure to settle claim.

16 **a. St. Paul Fire is not estopped from raising the "association risk only"  
17 coverage defense, which is a complete defense to coverage**

18 MVLLC claims St. Paul Fire is estopped from raising the "association risk only" because  
19 it failed to raise it in St. Paul Fire's initial reservation of rights letter. MVLLC's argument fails  
20 for two reasons. First, estoppel cannot be applied to create insurance that never existed. Second,  
21 even if it did apply, St. Paul Fire cannot be estopped from raising this defense unless MVLLC  
22 can prove St. Paul Fire acted in bad faith to MVLLC's detriment, or that MVLLC was prejudiced  
23 by the late assertion of this defense. Because estoppel does not apply here, and even if it did  
24 MVLLC cannot prove bad faith or prejudice, St. Paul Fire is entitled to summary judgment.  
25  
26

**i. MVLLC cannot create coverage, by estoppel or otherwise, that was never purchased**

“One may not, by invoking the doctrine of estoppel or waiver, bring into existence a contract not made by the parties and create a liability contrary to the express provisions of the contract the parties did make.” *Saunders v. Lloyds of London, et al.*, 113 Wn.2d 330, 335-36, 779 P.2d 249 (1989). The Washington Supreme Court explained:

The underlying rationale is that an insurance company should not be required to pay for a loss for which it received no premium. [Cit. om.] That rationale supports precluding waiver or estoppel in situations where the insured attempts to broaden coverage to protect against risks not stipulated in the policy or expressly disclaimed.

*Saunders*, 113 Wn.2d at 336.

The Washington Supreme Court has established an exception to this rule where an insurer has a duty to defend a claim and breaches that duty by either defending in bad faith or in bad faith refusing to defend. *Kirk v. Mt. Airy Ins. Co.*, 134 Wn.2d 558, 563-64, 951 P.2d 1124 (1998). Here, there is no allegation that St. Paul Fire either defended in bad faith or in bad faith refused to defend. Because this policy was issued solely as a condominium association policy, St. Paul Fire never even had a duty to defend MVLLC.

More fundamentally, MVLLC has not alleged that St. Paul Fire breached its duty to defend. That is because, under the mistaken impression that it issued a policy that potentially covered the risk at issue, St. Paul Fire timely accepted the tender of defense, under a complete reservation of rights to deny coverage on any grounds, whether or not identified in the letter.<sup>88</sup> It notified MVLLC as soon as it was sure the policy did not apply,<sup>89</sup> but continued to defend *for two and a half more months* until it found another insurer (St. Paul Guardian) to do so.

<sup>88</sup> Andersen Decl. Exh. 28.

<sup>89</sup> Andersen Decl. Exh. 34.



MVLLC makes no allegation that it received an inadequate defense and, indeed, is currently arguing before the Court of Appeals that the amount for which it settled represents a reasonable resolution of its liability. Estoppel for breach of the duty to defend cannot apply.

**ii. Even if coverage by estoppel did apply, MVLLC's attempt to obtain it fails because it cannot prove bad faith or prejudice**

In order to preclude St. Paul Fire from raising the "association risk only" defense, MVLLC must prove bad faith or prejudice: "Under these forms of estoppel, insureds must demonstrate either that they suffered prejudice or that the insurer acted in bad faith when the insurer failed to raise all its grounds for denial in its initial denial letter." *Hayden v. Mutual of Enumclaw*, 141 Wn.2d 55, 63, 1 P.3d 1167 (2000). To survive summary judgment, the insured must come forward with evidence to establish the insurer's denial was unreasonable:

If the insured claims that the insurer denied coverage unreasonably in bad faith, then the insured must come forward with evidence that the insurer acted unreasonably. The policyholder has the burden of proof. The insurer is entitled to summary judgment if reasonable minds could not differ that its denial of coverage was based upon reasonable grounds.

*Smith v. Safeco*, 150 Wn.2d 478, 486, 78 P.3d 1274 (2003).

To prove a claim for bad faith, the insured must prove not only that the insurer breached the insurance contract, but that its breach was "unreasonable, frivolous, or unfounded." *Kirk v. Mt. Airy Ins. Co.*, 134 Wn.2d 558, 560, 951 P.2d 1124 (1998). Bad faith will not be found where a "denial of coverage or a failure to provide a defense is based upon a reasonable interpretation of the insurance policy." *Id.* While an insurer can breach its duty of good faith by conduct short of fraud or intentional bad faith, *Industrial Indem. Co. of the Northwest v. Kallevig*, 114 Wn.2d 907, 916-17, 792 P.2d 520 (1990), an insurer will not be penalized for a good faith mistake. *Kirk*, 136 Wn.2d at 280. Alleged "mistakes and clumsiness alone do not amount to bad faith." *Ins. Co. of Pennsylvania v. Highlands Ins. Co.*, 59 Wn. App. 782, 786, 801 P.2d 284 (1990). Neither will delay alone constitute bad faith where there is no unfounded or frivolous denial of benefits. *Felice v. St. Paul Fire & Marine Ins. Co.*, 42 Wn. App. 352, 361, 711 P.2d 1066 (1985). As long as the insurance company acts with honesty, bases its decision on adequate

1 information, and does not overemphasize its own interests, an insured is not entitled to base a  
2 bad faith claim against its insurer on a good faith mistake. *Kirk*, 136 Wn.2d at 280.

3 It is difficult to imagine how St. Paul Fire's mistake could be deemed made in bad faith  
4 when it harmed only St. Paul Fire — *i.e.*, St. Paul Fire paid for a defense it was not required to  
5 pay. Furthermore, there has been no allegation that the defense provided by St. Paul Fire or  
6 St. Paul Guardian was somehow inadequate or in bad faith. How could St. Paul Fire have  
7 committed an act of bad faith by providing a good faith defense that did not harm the insured?

8 Even if St. Paul committed bad faith, there is no cause of action if the alleged bad faith  
9 conduct did not cause MVLLC harm. In *Safeco v. Butler, et al.*, 118 Wn.2d 383, 389, 823 P.2d  
10 499 (1992), the Washington Supreme Court confirmed that "harm is an essential element of an  
11 action for bad faith handling of an insurance claim." If the insured meets its burden to prove bad  
12 faith, harm will be presumed, but that presumption is rebuttable. Making the presumption  
13 rebuttable "protect[s] insurers from frivolous claims." *Id.* at 390-92. The uninterrupted defense  
14 MVLLC received fully rebuts any presumption of harm.

15 Likewise, prejudice is required as an essential element of any cause of action for  
16 estoppel. Equitable estoppel has three elements, and focuses on the insured's justifiable reliance:

- 17 (1) an admission, statement, or act inconsistent with the claim afterwards  
asserted,
- 18 (2) action by the other party on the faith of such admission, statement, or act,  
and
- 19 (3) injury to such other party resulting from allowing the first party to  
20 contradict or repudiate such admission, statement, or act.

21 *Saunders*, 113 Wn.2d at 340. Essentially, "[i]n Washington, injury, prejudice and detrimental  
22 reliance have been used interchangeably to express the requirement that a party asserting  
23 equitable estoppel must show a detrimental change of position." *Kramarevsky v. Department of*  
24 *Social & Health Services*, 122 Wn.2d 738, 747, 863 P.2d 535 (1993).

25 St. Paul Fire in fact corrected its omission of failing to specifically raise the "association  
26 risk only" defense by bringing it to MVLLC's attention on July 6, 2004, just two months after

1 Craig Yeary, Major Case Unit Regional Director, Construction Defect Claims, was assigned the  
 2 file (and six months after St. Paul Fire sent its initial reservation of rights letter, expressly  
 3 reserving the right to rely on any coverage defense, whether or not identified in the letter).<sup>90</sup>

4 Mr. Yeary noticed the liability form no. 41326, ordered the underwriting file, realized  
 5 this was an association policy and ultimately determined it afforded no coverage for the  
 6 Association's claims against MVLLC. He sent the file to coverage counsel and the same day  
 7 notified MVLLC that the policy did not cover the construction claims against it because it was an  
 8 association policy. He told MVLLC it was "imperative" that it put on notice any other insurers  
 9 that might provide coverage, and said he would be back in touch shortly.<sup>91</sup>

10 It does not appear, as a result of this July 6, 2004 letter, that MVLLC did at that time put  
 11 any other insurers on notice. Mr. Yeary, however, continued to search for potential coverage for  
 12 MVLLC. On September 22, 2004, as promised, he sent a reservation of rights letter to MVLLC,  
 13 withdrawing from its defense under the St. Paul Fire policy but simultaneously providing it a  
 14 defense under the St. Paul Guardian policy.<sup>92</sup> MVLLC was completely defended, without  
 15 interruption, by either St. Paul Fire or St. Paul Guardian, for the entire underlying action.<sup>93</sup>

16 Three months before the first mediation, and nine months before the mediation that  
 17 settled the case, MVLLC knew St. Paul Fire's position was that this policy did not apply because  
 18 it covered association risks only. In pleadings and discovery, MVLLC has identified nothing it  
 19 would have done differently had it been notified of this defense earlier, nor has it identified any  
 20 other prejudice or harm it suffered because of the eight month delay in raising this defense.  
 21 When St. Paul asked the Meadow Valley defendants to state the basis of their bad faith claims,

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22 <sup>90</sup> *Id.*

23 <sup>91</sup> Andersen Decl. Exh. 34.

24 <sup>92</sup> Andersen Decl. Exh. 35.

25 <sup>93</sup> Hebert Dep. p. 78, ll. 23-25, p. 79, ll. 1-3, 14-15; Andersen Decl. Exh. 7; Yeary Dep.  
 26 p. 114, ll. 4-13; Andersen Decl. Exh. 33; "I felt that I didn't want to leave them in a position where they  
 weren't [defended]. I wanted to make sure that they continued to have a defense."

1 they responded with a vague explanation that did not articulate any detrimental change of  
2 position taken in reliance upon any act by St. Paul.<sup>94</sup>

3 In fact, Roger Hebert, managing member of MVLLC, testified he understood that  
4 St. Paul Fire's initial reservation of rights letter meant there may be no coverage under this  
5 policy.<sup>95</sup> Mr. Hebert further testified that Marjorie Syria of his office took care of insurance  
6 matters for his various legal entities, and that she and Mr. Hebert relied upon their insurance  
7 broker, Edith Jacks, to obtain appropriate coverage for each.<sup>96</sup> Edith Jacks has in turn testified  
8 that the St. Paul Fire policy was issued to MVLLC as the condominium association to provide  
9 condominium association liability coverage, not as a developer to provide construction liability  
10 coverage.<sup>97</sup> Thus, MVLLC itself understood that the St. Paul Fire policy did not provide the  
11 construction liability coverage it now seeks. Further, the fact that MVLLC was not misled as to  
12 the scope of coverage is alone sufficient to rebut any presumption of harm and deny the  
13 requested estoppel remedy. *See Capelouto v. Valley Forge Ins. Co., et al.*, 98 Wn. App. 7, 20-  
14 24, 990 P.2d 414 (1999). (An omission in a declination letter will not estop an insurer from  
15 denying coverage where the insured was not misled by the omission.)

16 *Hayden, et al. v. Mutual of Enumclaw Ins. Co.*, 141 Wn.2d 55, 1 P.3d 1167 (2000), is  
17 instructive. In *Hayden*, Hayden Farms sued a grafting expert, James Krause, for crop loss  
18 allegedly due to Krause's negligence. *Hayden*, 141 Wn.2d at 57-58. Krause tendered the suit to  
19 his insurer, who declined the tender based on certain policy exclusions. The parties settled and  
20 Krause assigned his insurance rights to Hayden Farms. Hayden Farms then sued the insurer for  
21 coverage. *Id.* at 59. On summary judgment in the declaratory judgment action, the insurer —  
22

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23 <sup>94</sup> Andersen Decl. Exhs. 37 and 38 at Interrogatory No. 4.

24 <sup>95</sup> Hebert Dep. p. 48, l. 25, p. 49, l. 1, p. 81, ll. 16-25, p. 82, ll. 1-14; Andersen Decl. Exh. 7.

25 <sup>96</sup> Hebert Dep. p. 23, ll. 20-25, p. 24, ll. 1-16, p. 26, ll. 23-25, p. 27, ll. 1-4, p. 32, ll. 16-25,  
p. 33, ll. 1-2, p. 34, ll. 13-24; Andersen Decl. Exh. 7.

26 <sup>97</sup> Jacks Decl. ¶ 17.

like St. Paul Fire here — raised additional defenses not identified in its initial letter. *Id.* at 60. Hayden Farms argued WAC 284-30-380 precluded the insurer from raising any defenses not raised in its initial denial letter, but the Washington Supreme Court disagreed. The court specifically ruled the insurer was *not* precluded from raising the additional defenses, noting, “preclusion or estoppel is inappropriate absent either prejudice or bad faith.” *Id.* at 61-62.

**iii. The bad faith failure to settle claims must be dismissed because St. Paul has reasonable bases upon which to contest coverage and coverage has not been determined**

As the Washington Supreme Court in *Truck Ins. Exch. v. VanPort Homes, Inc., et al.*, 147 Wn.2d 751, 761, 58 P.3d 276 (2002) held:

If the insurer is unsure of its obligation to defend in a given instance, it may defend under a reservation of rights while seeking a declaratory judgment that it has no duty to defend. A reservation of rights is a means by which the insurer avoids breaching its duty to defend while seeking to avoid waiver and estoppel. ‘When that course of action is taken, the insured receives the defense promised and, if coverage is found not to exist, the insurer will not be obligated to pay.’

St. Paul Fire and St. Paul Guardian have followed the course outlined by the *VanPort* court to avoid waiver and estoppel. After timely agreeing to defend both insureds under a reservation of rights, including appointing separate counsel for each, St. Paul Fire and St. Paul Guardian brought this declaratory judgment action to resolve their coverage dispute with the Meadow Valley defendants. St. Paul Fire and St. Paul Guardian cannot be estopped from denying coverage because they have refused to pay to settle claims for which they are in good faith contesting coverage. St. Paul had multiple reasonable bases for not offering amounts sufficient for a complete cash settlement of the Association’s claims and it cannot therefore be reasonably argued that its position was frivolous.<sup>98</sup>

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<sup>98</sup> Under the St. Paul Fire policy, St. Paul’s position is that the policy does not apply because MVLLC is not being sued for an association risk. And even if it did apply, the amount of covered property damage under the policy is no more than half a million dollars, an amount St. Paul has always been willing to pay. The rest is for faulty work that did not cause covered damage, or for building code violations such as, squeaky, bouncy or uneven floors; loose carpet or carpet seams; handrail brackets spaced inconsistently; main entry doors incorrectly hung or with insufficient weather stripping; garage

1 St. Paul also has another reasonable basis for having refused to pay any tendered  
 2 settlement: there was never a reasonable offer tendered that it could have been required to pay.  
 3 The underlying action settled for a \$7,200,000 covenant judgment settlement, which the trial  
 4 court deemed unreasonable and reduced to \$6,400,000. The Meadow Valley defendants will be  
 5 unable to meet their burden to show St. Paul refused a reasonable settlement, since, at the last  
 6 mediation before the covenant judgment, the Association's lowest demand was half a million  
 7 dollars *more* than what the trial court held was reasonable.<sup>99</sup>

8 **b. The Consumer Protection Act claim fails as a matter of law because**  
 9 **defendants cannot establish the essential elements of that claim**

10 In order to establish a violation of the Washington Consumer Protection Act ("CPA"), the  
 11 Meadow Valley defendants must prove that an act or practice of St. Paul (1) is unfair and  
 12 deceptive; (2) occurred in the conduct of trade or commerce; (3) affected the public interest;  
 13 (4) was the actual cause of injury to plaintiff's business or property; and (5) resulted in actual  
 14 injury. *Hangman Ridge v. Safeco*, 105 Wn.2d 778, 784-85, 719 P.2d 531, 535 (1986).

15 In their counterclaim, Meadow Valley defendants allege vaguely that St. Paul's actions  
 16 violated the CPA and damaged them.<sup>100</sup> But St. Paul defended the Meadow Valley defendants in  
 17 good faith and they have made no claim they were unsatisfied with the defense provided.  
 18 Causation of damages is an essential element of a CPA claim, *Hangman Ridge* at 784-85, and the  
 19

20 \_\_\_\_\_  
 21 doors that do not latch; improperly attached garage door openers; shower doors that either do not close or  
 22 are difficult to close; walls that are not straight or are out of plumb; unfinished interior cabinets;  
 23 insufficient attic insulation; no attic access; foggy fireplace glass; gaps in draft stop walls; adding a  
 24 second floor instead of an open two story living room; and roofline changes. Andersen Decl. Exh. 26.

25 Under the St. Paul Guardian policy, which does provide construction coverage, the evidence  
 26 shows that only four of the sixteen buildings at this condominium were completed when the policy ended,  
 so St. Paul Guardian would be responsible for, at most, one-quarter of otherwise covered property  
 damage. Andersen Decl. Exh. 2. This, again, is within a range that St. Paul has always offered to pay.

<sup>99</sup> Andersen Decl. Exh. 39.

<sup>100</sup> Answer, Affirmative Defenses, Counterclaims and Crossclaims, p. 19. ¶ 4.4.



1 Meadow Valley defendants cannot identify any unfair or deceptive act or practice that caused  
2 them compensable damages. As a result, this claim also fails as a matter of law.

3 **3. The underlying attorney's fees are not "costs taxed" against the insureds**

4 The \$1,600,000 covenant judgment attorney's fees are not "costs taxed" against the  
5 Meadow Valley defendants under either St. Paul policy, for the following reasons.

6 **a. Attorney's fees and costs are distinct concepts**

7 Both St. Paul policies provide that, in addition to limits, the insurer will pay "all costs  
8 taxed against any protected person in a suit."<sup>101</sup> "Costs taxed" is not defined in the policies. In  
9 Washington, undefined terms are given their plain, ordinary and popular meaning, and courts  
10 frequently look to standard English dictionaries to ascertain the meaning of undefined terms.  
11 *Boeing v. Aetna*, 113 Wn.2d 869, 877, 784 P.2d 507 (1990) (construing "damages").

12 When considering words used in a legal context, Washington courts consult Black's or  
13 Ballentine's Law Dictionaries for definitions. *Lynott v. National Union*, 123 Wn.2d 678, 689-90,  
14 871 P.2d 146 (1994) (construing "acquisitions"); *Matthews v. Penn-America*, 106 Wn. App. 745,  
15 749, 25 P.3d 451 (2001) (adopting narrow definition of "family" and denying coverage).

16 Black's Law Dictionary defines "taxation of costs" as:

17 The process of ascertaining and charging up the amount of costs in an action to  
18 which a party is legally entitled, or which are legally chargeable. See *e.g.* Fed. R.  
19 Civ. P. 54(d); 28 U.S.C.A. § 1920. See also Costs.

20 Black's Law Dictionary defines "costs" as:

21 A pecuniary allowance, made to the successful party . . . In federal courts, costs  
22 are allowed as a matter of course to the prevailing party unless the court otherwise  
23 directs; also, specified fees and certain court expenses may be taxed as costs.  
24 Fed. R. Civ. P. 54(d) . . . Generally, "costs" do not include attorney's fee unless  
25 such fees are by a statute denominated costs or are by statute allowed to be  
26 recovered as costs in the case.

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101 *Claim* means a demand which seeks damages.

*Suit* means a civil proceeding which seeks damages. Andersen Decl. Exh. 9 at bates  
no. SPT00930-SPT00931; Exh. 20 at SPT00782-SPT00783.



Fed. R. Civ. P. 54(d), in turn, defines costs as specifically excluding attorney's fees:

(1) *Costs Other Than Attorney's Fees.* Except when express provisions therefore is made either in a statute of the United States or in these rules, *costs other than attorney's fees* shall be allowed as of course to the prevailing party . . . such *costs may be taxed* by the clerk on one day's notice.

(2) *Attorney's fees.*

(A) Claims for *attorney's fees and related nontaxable expenses* shall be made by motion . . .<sup>102</sup>

Washington recognizes the same distinction. "Costs taxed" in a lawsuit typically refers to modest or symbolic expenses awarded as a matter of course to the prevailing party in litigation. The clearest expression of Washington law in this regard is *Hall v. Stolte*, 24 Wn. App. 423, 426, 601 P.2d 967 (1979), a decision interpreting CR 41(d). There, the court stated, CR 41(d) specifically permits only taxable costs to be recovered. *Taxable costs do not include the award of reasonable attorney's fees.*

(Emphasis added). With respect to the word "costs," courts have long made it clear that that term does not include attorney's fees:

The term "costs" may be considered as synonymous with the term "expense." Costs are allowances to a party for the expense incurred in prosecuting or defending a suit. 15 C.J. 20. The word "costs" in the absence of statute or agreement does not include counsel fees; in other words, the general rule is that counsel fees are not costs either in suits in equity or actions at law.

*State ex rel. Macri v. Bremerton*, 8 Wn.2d 93, 102, 111 P.2d 612 (1941). Unless the statute authorizing their recovery indicates they are costs, courts consider attorney's fees damages:

Similarly, any award of attorney's fees sought under RCW 49.48.030 is *not sought as part of the costs* of this action; rather, Dr. Brown seeks attorney's fees as *additional damages* for defendant's failure to comply with RCW 49.48.010.

*Brown v. Suburban Obstetrics & Gynecology*, 35 Wn. App. 880, 884, 670 P.2d 1077 (1983) (emphasis added).<sup>103</sup> More recent cases continue to recognize the distinction. In *Panorama Village v. Allstate*, 144 Wn.2d 130, 26 P.3d 910 (2001), the court stated:

<sup>102</sup> Fed. R. Civ. P. 54(d) (1) and (2) (emphasis added).

<sup>103</sup> The statute in *Brown* was substantially similar to the attorney's fee provision in the Washington Condominium Act, in that it did not provide for attorney's fee as costs:

1 It must be noted that there is a difference between an entitlement to collect  
 2 “reasonable attorney’s fees” and an entitlement to collect those statutory “costs”  
 3 enumerated in RCW 4.84.010. *Costs have historically been very narrowly*  
*defined*, and RCW 4.84.010 limits cost recovery to a narrow range of expenses  
 4 such as filing fees, witness fees, and service of process expenses.

5 **b. The Condominium Act does not define attorney’s fees as “costs”**

6 The Association sued the Meadow Valley defendants under the Condominium Act,  
 7 RCW 64.34, *et seq.* RCW 64.34.455 allows for recovery of attorney’s fees, but not as costs:

8 If a declarant or any other person . . . fails to comply with any provision  
 9 hereof . . . any person or class of persons adversely affected by the failure to  
 10 comply has a claim for appropriate relief. The court, in an appropriate case, may  
 11 award reasonable attorney’s fees to the prevailing party.

12 In *Park Ave. v. Buchan Devs.*, 117 Wn. App. 369, 388, 71 P.3d 692 (2003), the court,  
 13 construing this provision, refused to consider attorney’s fees litigation expenses:

14 The trial court awarded Park Avenue its reasonable attorney’s fees under  
 15 RCW 64.34.455. Park Avenue contends the court should have construed the term  
 16 “attorney’s fees” liberally to allow for an additional award of litigation expenses  
 17 in order to make it whole. *We disagree.*

18 (Emphasis added.)

19 Then, in *Eagle Point v. Coy*, 102 Wn. App. 697, 707, 9 P.3d 898 (2000), the court, citing  
 20 the well-established rule that attorney’s fees are not costs unless a statute defines them as such,  
 21 refused to consider attorney’s fees as costs under the Condominium Act because the statute did  
 22 not define them that way:

23 Attorney’s fees are not included in the “costs” that can be shifted under CR 68,  
 24 unless the governing statute specifically defines attorney’s fees as costs . . . *The*  
 25 *condominium statute does not define attorney’s fees as costs.*

26 **c. A layperson would have no idea what “costs taxed” means**

A layperson would have no idea what “costs taxed” means. While the Meadow Valley  
 defendants will argue “costs” and “taxed” have a lay, popular meaning because they are found in

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In any action in which any person is successful in recovering judgment for wages or  
 salary owed to him, reasonable attorney’s fees, in an amount to be determined by the  
 court, shall be assessed against said employer or former employer . . . .  
 RCW 49.48.030.

the dictionary, this argument ignores the fact that words like “habeas corpus,” “replevin” and “mandamus” are in the dictionary too, yet they have no popular, lay meaning. The Meadow Valley defendants rely on *Boeing*, 113 Wn.2d 869. In that case, however, the court was construing the word “damages,” a word that has a legal meaning understandable to a layperson. “Damages” also has an archaic and hyper technical meaning that arguably excludes sums awarded in equity, and it was this meaning that the *Boeing* court rejected. With its broad construction of the word “damages,” the *Boeing* decision supports St. Paul’s position that attorney’s fees are damages subject to the limitations of coverage, and not “costs taxed.”

To the extent there can be a lay understanding of “costs taxed” in a lawsuit, it is likely not distinguishable from the legal meaning of costs, which is distinct from attorney’s fees. The fee agreement between the Association and its former law firm makes the distinction between attorney’s fees and costs innumerable times in the body of the agreement.<sup>104</sup> And personal injury attorney Yellow Page ads make the distinction when they promise, “no recovery, no fee!” but warn the client must still pay “costs.”

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<sup>104</sup> Andersen Decl. Exh. 40, Amended Levin & Stein Fee Agreement. Twelve of the 28 paragraphs in this agreement discuss either attorney’s fees or costs, and the terms are not interchangeable.

Paragraph 2 defines “any recovery” as “attorney’s fees, less costs,” and defines “total recovery” as “repair costs or other damages,” “attorney’s fees” and “investigative and litigation costs.”

Paragraph 6 defines “costs” as:

[c]ourt filing fees, arbitration expenses, process server fees, private investigator fees, messenger fees, copy costs, postage, long distance telephone charges, parking, court reporter fees, jury fees, consultant fees, destructive and non-destructive defect investigation expenses and fees charged by the mediator if the claims go into mediation, and similar costs incurred in the prosecution, arbitration or mediation of construction defect claims.

Nowhere in this substantial list of what constitutes “costs” is the term attorney’s fees.

Finally, paragraph 12 is divided into costs and fees. It states that attorneys will be entitled to reimbursement of costs advanced for the client, and that attorneys are entitled to a contingent fee.

Given this agreement, the Association must have known attorney’s fees are not costs.

**d. Idaho's *Harvey* rule does not apply in Washington**

The Idaho Supreme Court's reasoning in *Mutual of Enumclaw v. Harvey*, 115 Idaho 1009, 772 P.2d 216 (1989) would be inappropriate in Washington. The *Harvey* court held that "costs taxed" included attorney's fee awards regardless of an insurer's reservation of rights defense, providing two reasons for its ruling. First, it held that the ordinary purchaser of insurance would understand "costs taxed" to include attorney's fees. (For the reasons set forth above, that holding is dubious.) Second, it held that such an interpretation was necessary in order to prevent opportunism by the insurer who had taken the case all the way through trial:

Beyond what appears to be the clear term of the policy, it is arguable that since the Company has the right to control the defense, *including the power to refuse settlement*, it should also bear the consequences of its case management decisions, including the consequence that the trial court may tax the opponent's costs against the insured.

*Harvey*, 115 Idaho at 1012 (emphasis added).

The underlying premise of this holding — that the insurer controls the defense and settlement — is not true in Washington. Here, where an insured is being defended under a reservation of rights, it is the insured, not the insurer, that controls the defense and has the ultimate choice with respect to settlement. *Tank v. State Farm Fire & Cas. Co.*, 105 Wn.2d 381, 388-89, 715 P.2d 1133 (1986). There is no clearer example of this than the Meadow Valley defendants' settlement with the Association — undertaken without St. Paul's knowledge or consent. In fact, it was presented to St. Paul as a done deal. In Washington, insurer-appointed defense counsel represent only the insured and must understand that the insured is the only client. *Id.* at 388. Throughout the underlying action, defense counsel appointed by St. Paul answered only to the Meadow Valley defendants and their personal counsel, Mark Davidson, not to St. Paul or its attorneys. St. Paul did not control the defense of this matter, which was resolved in such a way as to maximize the insurers' (and minimize the insureds') exposure.

In Washington, therefore, the shoe is on the other foot with respect to potentially opportunistic behavior. The insured facing liability for non-covered claims would have an

1 incentive to offer the claimant an inflated attorney's fee award that is in reality partial  
 2 compensation for uncovered damage claims, expanding coverage unilaterally and exculpating  
 3 itself from liability.

4 Washington courts have consistently stated that they "do not propose to discourage  
 5 reservation of rights defenses" and that "such a defense usually provides a valuable service to the  
 6 insured." *Tank*, 105 Wn.2d at 390. They have also stated that "[i]f the insurer is unsure of its  
 7 obligation to defend in a given instance, it may defend under a reservation of rights while  
 8 seeking a declaratory judgment that it has no duty to defend." *Truck Ins. Exch. v. VanPort*  
 9 *Homes*, 147 Wn.2d 751, 761, 58 P.3d 276 (2002). This unequivocal encouragement to insurers  
 10 to defend under a reservation of rights would be jarringly inconsistent with a ruling that  
 11 rewarded an insured's attempt to create automatic liability for statutory attorney's fees against  
 12 the insurer that had stepped up to defend. Such an interpretation encourages insurers not to  
 13 defend under a reservation of rights but instead to deny a defense whenever it has a colorable,  
 14 good faith basis for doing so, to avoid potential liability for the plaintiff's attorney's fees.  
 15 *Harvey* is inapposite to Washington insurance jurisprudence.

16 **e. "Costs taxed . . . in a suit" does not apply to covenant judgment**  
 17 **settlements**

18 The St. Paul "additional payments" provision states that the insurer will "pay all costs  
 19 taxed against any protected person in a suit." A "suit" is distinguished from a "claim," with the  
 20 latter defined as a "demand which seeks damages." The Meadow Valley defendants agreed to  
 21 the Association's settlement demand at a mediation and the amount of the settlement was not  
 22 determined in "suit." Thus, no amount agreed to in response to a demand could be "costs taxed"  
 23 in a "suit" within the meaning of the policies.

24 This interpretation makes sense in light of *Harvey*, 115 Idaho 1009. In *Harvey*, unlike  
 25 here, the underlying action proceeded to a full jury trial. The *Harvey* court reasoned that  
 26 attorney's fees should be awarded because by taking the case to trial the insurer (who, in Idaho,  
 unlike here, controls the defense) needed to "bear the consequences of its case management

1 decisions, including the consequence that the trial court may tax the opponent's costs against the  
 2 insured." *Harvey* at 1012. The court was saying, in essence, that the "costs taxed" provision  
 3 protected the insured's policy limits from the risk the insurer took by deciding to try the case  
 4 instead of settling it. By its own terms this reasoning does not apply to settlements such as the  
 5 one between the Meadow Valley defendants and the Association. Since the Meadow Valley  
 6 defendants spared themselves the risk of a real trial by settling a "claim," they cannot at the same  
 7 time legitimately claim the right to "costs taxed" coverage.

8 **f. If St. Paul is liable for the attorney's fees at all, it is as indemnity**  
 9 **damages**

10 If St. Paul is liable for the covenant judgment attorney's fee award at all, it should be as  
 11 "damages" within the policies' coverage grants. If attorney's fees not awarded as costs (as fees  
 12 under the Condominium Act are not awarded as costs, *Eagle Point v. Coy*, 102 Wn. App. 697,  
 13 707, 9 P.3d 898 (2000)), Washington considers them to be an element of damages. *Brown v.*  
 14 *Suburban Obstetrics & Gynecology*, 35 Wn. App. 880, 884, 670 P.2d 1077 (1983). Washington  
 15 courts have given the terms "damages" as used in an insurance policy a broad construction.  
 16 *Boeing, supra*. Other courts have reached similar conclusions.

17 In *Ypsilanti v. Appalachian Ins. Co.*, 547 F. Supp. 823, 828 (D. Mich. 1982), the court  
 18 found "a reasonable person in the position of the insured would believe that the words 'all sums  
 19 which the insured shall become legally obligated to pay as damages' would provide coverage for  
 20 all forms of civil liability, including attorney's fees." On the other hand, when a statute defines  
 21 attorney's fee as costs, courts have, commensurately, not considered them to be damages. *See*  
 22 *Sullivan County v. Home Indem. Co.*, 925 F.2d 152, 153 (6th Cir. 1991).<sup>105</sup>

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23  
 24 <sup>105</sup> The Seventh Circuit, in *United States v. Security Mgmt. Co.*, 96 F.3d 260, 269-270 (7th  
 25 Cir. 1996) held that attorney's fee under the Fair Housing Act, which separates fees from costs, were  
 26 neither "damages" nor "costs," but were instead as separate statutory remedy and thus the insurer had no  
 duty to pay them under any circumstances.

1 Attorney's fees, like other forms of damages, are subject to discretionary evaluation,  
 2 while the small, fixed costs typically taxed in suits such as filing and service of process fees are  
 3 not. If a portion of this claim is covered (and St. Paul has always maintained that a portion is),  
 4 liability for the attorney's fees should be allocated proportionately to covered damages. *State*  
 5 *Farm v. English Cove Ass'n*, 121 Wn. App. 358, 371, 88 P.3d 986 (2004).

### 6 **C. Conclusion**

7 For all of the above reasons, St. Paul requests this Court enter an order declaring that  
 8 St. Paul is entitled to summary judgment as a matter of law (1) dismissing MVLLC's breach of  
 9 contract claim against St. Paul Fire with prejudice; (2) dismissing the Meadow Valley  
 10 defendants' bad faith and CPA claims against St. Paul Fire and St. Paul Guardian with prejudice;  
 11 and (3) dismissing the Meadow Valley defendants' "costs taxed" claim against St. Paul Fire and  
 12 St. Paul Guardian with prejudice. A proposed order is attached.

13 Dated this 29th day of June, 2006.

14 GORDON & POLSCER, L.L.C.

15  
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**CERTIFICATE OF SERVICE**

I hereby certify that on June 29, 2006, I electronically filed the following:

- **Plaintiffs St. Paul Fire And Marine Insurance Company And St. Paul Guardian Insurance Company's Motion For Partial Summary Judgment; and**
- **Certificate of Service;**

with the Court using the CM/ECF system which will send notification of such filing to the following:

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